In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 33

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

RAYMOND I. BASHFORD

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

SUPPLEMENTAL BRIEF FOR THE PETITIONER

On November 8, 1937, this Court announced its decision in *Groman* v. *Commissioner,* No. 21, October Term, 1937. On the same day the instant case, which had been argued before this Court at the same time and in connection with the *Groman* case, was set down for reargument. Though the facts of the two cases vary slightly, the two cases involve essentially the same question, i. e., whether a parent corporation may be considered a party to a statutory reorganization conceded to have been effected between its subsidiary, organized for the specific

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purpose, and another corporation.[1] The argument advanced in our original brief, we believe, is entirely consistent with the rule enunciated by this Court in the *Groman* case. It is thought, however, that a discussion of the underlying principle of the *Groman* case with relation to the facts here will be helpful, and accordingly this supplemental brief is submitted.

In the *Groman* case the Glidden Company, pursuant to contracts previously entered into, organized a new corporation, here called Ohio, for the express purpose of acquiring all of the stock and thereafter the assets of the Metals Refining Company of Indiana, herein called Indiana. The details of the plan were incorporated in a contract between Glidden and the shareholders of Indiana, wherein it was recited that the stockholders of Indiana were desirous of merging and consolidating the properties of their company with Glidden and with the new corporation, Ohio, to be organized by Glidden. The shareholders of Indiana, of whom the petitioner there was one, covenanted that they would assign their shares to Ohio, which was to have a specified capital structure divided into preferred and common shares. Glidden covenanted that it would issue and deliver or cause to be issued and delivered to the shareholders a stated number of shares of its own prior preference stock

[1] The pertinent provisions of the Revenue Act are set forth in the Appendix to petitioner's original brief, pp. 37–41.

at an agreed valuation, a stated number of shares of the preferred stock of Ohio, also at an agreed valuation and sufficient cash to equal the appraised value of Indiana's assets as of March 1, 1929, and that, after the exchange of stock, Glidden would cause Indiana to transfer its assets to Ohio.

Glidden organized Ohio and became the owner of all of its common stock, but none of its preferred stock. Pursuant to the contract, the shareholders of Indiana transferred their stock to Ohio and received therefor a total consideration consisting of Glidden prior preference stock, shares of the preferred stock of Atlas, and cash. Indiana then transferred its assets to Ohio and was dissolved.

This Court held that Glidden was not a party to the statutory reorganization effected between Indiana and Ohio either within the strict meaning of Section 112 (i) (2) of the Revenue Act of 1928, which was said not to be an all-inclusive definition, or within the ordinary connotation of the term; that the gain to the petitioner represented by the Glidden stock was not unrecognized under Section 112 (b) (3); and that, accordingly, the Glidden stock must be treated as "other property" within the purview of Section 112 (c) (1).

In the case at bar the Atlas Company, we contend, occupies a position wholly analogous to and indistinguishable in legal effect from that of Glidden in the *Groman* case, and thus the rule of the *Groman* decision requires a similar result here.

The facts of this case are set out in the original Brief for the Petitioner, pp. 2–8. To review them briefly, it is sufficient to recite that in the instant case, the Atlas Powder Company (like Glidden in the *Groman* case) conceived and executed a plan whereby its subsidiary, Peerless-Union Explosives Corporation, called the new company, was organized for the purpose of acquiring and did acquire the stock and the assets of three existing corporations called Peerless, Union, and Black Diamond. Desiring not to disclose its identity in the beginning, Atlas conducted negotiations with the majority stockholders of Peerless, Union, and Black Diamond through two agents acting as promoters of the new company. When oral agreements had been reached, Atlas was disclosed as the principal. Contracts were signed under which the agents obtained the right to acquire, on behalf of the new company, a majority of the stock of Peerless, Union, and Black Diamond in exchange for stock of the new company, stock of Atlas, and cash, to be delivered to the stockholders of the old companies. The agents warranted that the new company would acquire all the assets of the three old companies and that the old companies would then be dissolved.

The new company was duly organized by Atlas pursuant to the agreements. Atlas subscribed to all of its original issue of common and preferred stock, which was all issued to Atlas.

On October 2, 1930, a special meeting of the Board of Directors of Atlas was held and upon motions duly adopted the actions of its exeeutive officers in causing the formation of the new company for the purpose of acquiring the assets and business of Peerless, Union, and Black Diamond, and the plan of reorganization, were approved. The officers of Atlas were empowered and directed to invest in the capital stock of the new company up to a specified aggregate, and in consideration therefor to deliver to the new company cash, shares of Atlas preferred stock and shares of Atlas common stock in substantial amounts.

All of the transfers and exchanges were made pursuant to the agreements, the assets of the three old companies were transferred to the new company and the old companies were dissolved. Upon completion of the stock exchanges on October 7, 1930, and after the issuance of additional stock by the new company, Atlas owned 100 per cent of the preferred stock of the new company and approximately 57 per cent of its common stock, and the former stockholders of Peerless and Union owned approximately 43 per cent of the common stock of the new company. (R. 49–56, 129–133.)

From the foregoing, we submit that the transactions in the instant case and the *Groman* case are in all essential respects the same. We believe that there can be pointed out but two distinctions between the plan adopted by Glidden in the *Groman*

case and that by Atlas in this case, and that these differences have no legal significance and are insufficient to require different results under the same provisions of the Revenue Act of 1928.

The first distinction is in the methods adopted by the parent corporations in their dealings with the stockholders of the corporations of which they desired to obtain control. In the *Groman* case, Glidden was a direct party to the contract whereby the shareholders of Indiana agreed to transfer their stock to Ohio. Here, on the other hand, Atlas was not a party to the principal contract setting forth the plan of the exchanges because Atlas remained undisclosed while its agents opened the negotiations. Atlas' rights were derived through the contracts of its agents. It is true that under these contracts the agents of Atlas had the right to receive the stock of the old companies but plainly the right itself was restricted to their agency to receive it for the new corporation.

The main features of the plan, as shown by the unchallenged findings of the Board, "were that Peerless, Union and Black Diamond *were to be consolidated into the new company,* Peerless-Union Explosives Corporation, that the stockholders of the old companies would receive for their stock in the old companies stock in the new company, stock in Atlas and some cash" (R. 130–131). [Italics added.] Further, Atlas' agents were instructed that Atlas did not desire to purchase "either the

assets or stocks of Peerless, Union or Black Diamond, but to reorganize them into a new company by the exchange of stocks, which new company would be controlled by Atlas" (R. 130). Thus, while the negotiators may have been agents of Atlas with respect to the general transaction, they could not have been agents who were acquiring the stock for Atlas. Also, it appears from the testimony of the president of Atlas that "in effecting the plan, it was made known to each of the stockholders of Peerless and Union that their participation in these exchanges was based upon all various steps being consummated up to the conclusion of the plan which took place on October 7th; that the stockholders of the so-called majority group of both the Peerless and the Union agreed to deposit their stock and agreed to go through with certain agreements *provided the whole plan was consummated;* * * *" (R. 158). [Italics added.]

If, upon the basis of these facts, it should be argued by the respondent that Atlas through its agents in effect acquired "at least a majority of the voting stock" and of the total number of shares of other classes of stock of the old corporations and thus complied with the statutory language of Section 112 (i) (1) (A), we believe that such argument would be overcome by the indisputable fact that Atlas, through its agents, received such stock for the sole and express purpose of immediately

passing it on to the new company. In other words, it appears that the Atlas agents at the most were nothing more than conduits through which the subsidiary acquired the stock of the old companies. In the words of Atlas' president (R. 158), "participation in these exchanges was based upon all various steps being consummated" in accordance with the plan and agreements. All of the transfers and exchanges were contracted for and made on the same day—October 7, 1930 (R. 26, 27, 28, 29, 136). At best, the acquisition of and possession by the agents of Atlas of the stock of the old companies were fleeting and transitory. It is settled that such an intermediate transfer does not constitute an "acquisition" within the meaning of the statutory definition of a reorganization (*Bassick* v. *Commissioner,* 85 F. (2d) 8, 10 (C. C. A. 2d), certiorari denied, 299 U. S. 592, rehearing denied, 299 U. S. 623); also, that such intermediate transfers may not be regarded as separate and distinct transactions (*Starr* v. *Commissioner,* 82 F. (2d) 964, 967, 968 (C. C. A. 4th), certiorari denied, 298 U. S. 680). Even if such a transfer can be regarded as an acquisition in form by Atlas' agents, obviously it was not "the thing which the statute intended." *Gregory* v. *Helvering,* 293 U. S. 465, 469. Moreover, to treat the transfer as an acquisition by Atlas would plainly disregard the "main features" of the plan as agreed to and carried out (R. 130–131). Thus, in fact and in law, we think there is no

room for the contention that Atlas, through its agents, "acquired" the stock of the old companies and thus effected a compliance with the statutory definition.

The second distinction in the facts of the two cases is found in the circumstance that, at the consummation of the transactions, Atlas (unlike Glidden) held a majority of both the preferred and common stock of its subsidiary. Section 112 (i) (2) provides that the term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.[2] In the instant case it is conceded that there was a reorganization between the old companies, Peerless, Union, and Black Diamond, and the new company. It cannot be denied that Atlas acquired a majority of the voting and all other classes of the new company's stock.

We believe that the acquisition by Atlas of a majority of the voting and all other classes of stock of

[2] In the opinion of the *Groman* case (page 3) it was said that if Section 112 (i) (2) is an exclusive definition of a party to a reorganization, which it was there held not to be, Glidden was not within its terms for it was not a corporation resulting from the reorganization and "it did not acquire a majority of the shares of the voting stock and a majority of the shares of all other classes of stock of *any other corporation in the reorganization.*" (Italics added.)

the new company does not render Atlas a party to the conceded reorganization between the new company and the three old companies. The taxpayer was a stockholder of Peerless. The question is whether the stock of Atlas he has received in the Peerless reorganization is to be recognized. Atlas' tax liability growing out of its part in these transactions is not involved. We have developed at pages 15–17 of our original brief in this case our contention that Atlas is not a party to the reorganization between the old companies and the new because of its acquisition of the new company's stock, and we believe the *Groman* decision has not lessened the effect of that argument.

Thus, Atlas did acquire a majority of the stock of "another corporation." Under Section 112 (i) (2) this may have made it a party to a reorganization between Atlas and the new company. It could not serve to make it a party to a reorganization of corporations the stock of which was not acquired by Atlas. We believe that to cause Atlas to be a party to the reorganization in question because it acquired a majority of the voting and all other classes of stock of another corporation, it must be shown that the stock of the corporation asserted to be a party (here, Atlas) represents the continuity of interest required by the reorganization provisions under the *Groman* and other decisions of this Court.[3]

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[3] *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, 385, and related cases.

The mere fact that a parent corporation is intimately connected with a reorganization plan, and perhaps a party to other tax free exchanges constituting a part of that plan, can not alone qualify it as a party to the exchange out of which the taxable transaction arose. This is true in this case because the Atlas stock, like that transferred in *Bus & Transport Corp.* v. *Helvering,* 296 U. S. 391, represents only an indirect interest, and not a definite and material interest, in the assets and affairs of the subsidiary corporation. See petitioner's original brief, pp. 26–29; *Groman* v. *Commissioner, supra.*

The underlying principle of the decision in the *Groman* case we believe is found in the statement of the Court (Opinion, p. 6) that a compliance with the purpose of the reorganization sections is had only "where, pursuant to a plan, the interest of the stockholders of a corporation continues to be definitely represented in substantial measure in a new or different one, then to the extent, but only to the extent, of that continuity of interest, the exchange is to be treated as one not giving rise to present gain or loss."

We submit that this rule, applied to the facts of the instant case, requires the conclusion that the stock of Atlas no more represents a definite, material, and substantial interest in the transferred assets than did the stock of Glidden in the *Groman* case. The Atlas stock carried no proprietary inter-

est in the assets of the new company, for such an interest could be obtained only through the stock of the new company itself which held the transferred assets of the old companies. Not only does Atlas' stock carry but an indirect interest in the assets of the old companies, but it represents an entirely new and distinct interest. This is so because Atlas' stock carried an interest only in the assets of Atlas, a part of which, it is true, was the common and preferred stock of the new company. But this is not the immediate and direct interest required by the statute. *Bus & Transport Corp.* v. *Helvering,* 296 U. S. 391, 392.

Failing the crucial test of continuity of interest in the transferred assets, Atlas did not become a party to the reorganization between its subsidiary and the old companies by reason of its participation in carrying out such reorganization. Nor does the difference in degree of its stock control over its subsidiary, as compared with that of Glidden over its subsidiary, supply the continuity of interest required by the statute. To reject the plain meaning of the term "party" and to attribute that relation to Atlas, would be not only to disregard the letter but also to violate the spirit of the Revenue Act.

Consequently, Atlas may not be regarded as a party to the reorganiaztion and the gain upon its

stock must be recognized under the express language of Section 112 (c) (1).

Respectfully submitted.

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